No. 86-1857

Supreme Court, U.S.
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IN THE

# Supreme Court of the United States

**October Term, 1986**

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CONTINENTAL BANK INTERNATIONAL,
*Appellant,*

*against*

CITY OF NEW YORK, DEPARTMENT OF FINANCE,
*Appellee.*

ON APPEAL FROM THE COURT OF APPEALS OF THE STATE OF NEW YORK

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## Brief *Amicus Curiae* on Behalf of the State of New York

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Dated: July 15, 1987

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## Questions Presented

1. Whether Edge Act (12 USC § 611 *et seq*) corporations are federal instrumentalities constitutionally immune from state and local taxation absent affirmative congressional consent.

2. Whether Congress has by statute (12 USC § 627) exempted from state and local taxation Edge Act corporation branch offices located in states other than such corporation's home office state.

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ON APPEAL FROM THE COURT OF APPEALS OF THE STATE OF NEW YORK

# BRIEF *AMICUS CURIAE* ON BEHALF OF THE STATE OF NEW YORK

## Interest of *Amicus Curiae*

Since the passage of the Edge Act (12 USC § 611 *et seq.*) in 1919, over 100 corporations organized under the Act have been established and are currently doing business in the State of New York. Until now, there has been no question that all such corporations are subject to state taxation under either Article 32 ("Franchise tax on banking corporations") or, in a few instances, Article 9-A ("Franchise tax on business corporations") of the New York Tax Law (§ 1450 *et seq.* and § 208 *et seq.*, respectively). The current annual income to the State of New York from the taxes imposed on Edge corporations is approximately $2,000,000.

Until a change in the regulations of the Federal Reserve Board adopted in 1979, corporations organized under the Edge Act had been foreclosed from establishing branch offices within the United States.[1] Thus, every such corporation had to be individually chartered and, pursuant to 12 USC § 627, was expressly subject to nondiscriminatory taxation in its home state. Since the advent of domestic branching in 1979, a number of Edge corporations originally established in New York have been dissolved and have reemerged as branches of out of state Edge corporations. If, as a result of this litigation, the State of New York may no longer tax these businesses operating in New York, the state will not only suffer an immediate revenue loss, it will no doubt incur further losses in the future as more and more of New York's Edge corporations take advantage of this new loophole by the expedient of corporate reorganization and the establishment of a "home office"

[1] Compare, Regulation K, 12 CFR § 211.6(a) (1979) ("* * * A[n Edge Act] Corporation may not establish any branch in the United States * * *"), with 12 CFR § 211.4(c)(1) (1980) ("* * * With prior Board approval, an Edge Corporation may establish branches in the United States * * *").

outside New York. The interest of the State of New York in the outcome of this proceeding is, therefore, substantial and we respectfully ask the Court to consider this brief in ruling upon appellee's motion to dismiss or affirm.

## ARGUMENT

**This appeal presents no substantial Federal question.**

The issues appellant seeks to raise on this appeal do not warrant this Court's review. As is demonstrated below, the decision of the New York Court of Appeals rejecting appellant's attempt to establish for itself a new tax loophole neither required by the Constitution nor ever contemplated by Congress was clearly correct.

It should also be noted that the only recent decision interpreting 12 USC § 627, the statute at issue here, rejected a claim similar to that urged by appellant and was also found by this Court not to warrant further review. *See, City of Houston v Morgan Guaranty International Bank,* 666 SW2d 524 (Tex App 1983), *cert den,* 469 US 1213 (1985).

**A. Edge Act corporations are not federal instrumentalities and have no constitutional immunity from state and local taxation. Affirmative congressional consent to such taxation is therefore unnecessary.**

*McCulloch v Maryland,* 4 Wheat 316 (1819), established the principle, rooted in the Supremacy Clause (US Constn, Art VI, Cl 2), that the federal government and the operations of its instrumentalities are immune from state taxation absent congressional consent. Over the ensuing years, this Court has struggled with the question of what constitutes a federal instrumentality for tax immu-

nity purposes. Recently, in *United States v New Mexico,* 455 US 720 (1982), the Court reviewed the historical development of this doctrine, noting that, contrary to some past interpretations, "a narrow approach to governmental tax immunity accords with competing constitutional imperatives, by giving full range to each sovereign's taxing authority". 455 US at 735-736. The Court further observed that, taken as a whole, its decisions teach "that tax immunity is appropriate in only one circumstance: when the levy falls on the United States itself, or on an agency or instrumentality so closely connected to the Government that the two cannot realistically be viewed as separate entities, at least insofar as the activity being taxed is concerned". 455 US at 735. *See also, Department of Employment v United States,* 385 US 355, 359-360 (1966), and *Standard Oil Co. v Johnson,* 316 US 481, 485 (1942). It is submitted that Edge corporations[2] do not qualify as federal instrumentalities and are therefore not entitled to the benefit of the United States government's state tax immunity.

An Edge corporation is a privately-owned, profit-making enterprise with only peripheral connections to the government. While it is federally chartered and is subject to some regulatory supervision, these factors hardly make an Edge corporation "virtually * * * an arm of the Government", *Department of Employment v. United States,* 385 US at 359-360, and are insufficient to sustain the conclusion that such an entity is a federal instrumentality. *Broad River Power Co. v. Query,* 288 US 178, 180-181 (1933). An Edge corporation is subject to no special federal audits or supervision, no part of its management is appointed by

[2]In its jurisdictional statement, appellant refers to Edge Act corporations as "banks". This designation is not accurate, in that Edge corporations have only limited powers and are not truly banks. It is significant that the terminology used in both the Edge Act itself and the implementing regulations (12 CFR § 211.4) refers only to "corporations", not "banks".

the government, it receives no federal assistance, and most importantly, it performs no governmental functions and fulfills no governmental obligations. *See, Department of Employment v. United States,* 385 US at 359 (holding that the Red Cross is a federal instrumentality based upon the presence of these factors).

Appellant contends that Edge corporations are entitled to the same constitutional immunity as national banks. This position fails for several reasons. First, it is unlikely that, in 1987, this Court would conclude that national banks themselves should continue to be regarded as constitutionally tax immune. In *First Agricultural National Bank of Berkshire Co. v. State Tax Commission,* 392 US 399 (1968), the Court explicitly declined to reach the question of whether national banks have, over the years, retained their character as federal instrumentalities, 392 US at 341, holding instead that the tax at issue was precluded by congressional legislation.[3] 392 US at 343. In dissent,

[3]It is interesting to note that a year after this decision, Congress amended the pertinent legislation to remove the last vestige of national bank tax immunity. As amended by PL 91-156, 83 Stat 434, in 1969, 12 USC § 548 now reads:

> "For the purposes of any tax law enacted under authority of the United States or any State, a national bank shall be treated as a bank organized and existing under the laws of the State or other jurisdiction within which its principal office is located."

Senate Report No. 91-530 explained the rationale behind the change:

> "There may have at one time been justification for giving national banks privileges and immunities which were denied State banks, under the theory that national banks are peculiarly an instrumentality of the Federal Government, and, as such, hold a unique and distinct position from that of other institutions. Without specifically addressing the question of whether national banks remain, in substance, such a Federal instrumentality, the committee is agreed that there is no longer any justification for Congress continuing to grant national banks immunities from State taxation which are not afforded State banks." 1969 USCCAN 1595.

Justice Marshall (joined by Justices Harlan and Stewart) addressed the constitutional question and concluded that by 1968, national banks had for all intents and purposes become no different from state-chartered banks. 392 US at 356-358. Justice Marshall pointed out that beginning with the passage of the Federal Reserve Act of 1913 (38 Stat 251, as amended, 12 USC § 221 *et seq*), national banks had started to lose those quasi-governmental characteristics which had previously resulted in their designation as federal instrumentalities. *Id.* Thus, he would hold "that national banks, today, are not immune from nondiscriminatory state taxation as federal instrumentalities". 392 US at 358-359.

Second, there are a significant number of legal and functional differences between national banks and Edge corporations which preclude the mechanical expansion of the former's immunity to cover the latter.[4] For example, Edge corporations are prohibited from being members of the Federal Reserve System, while national banks are required to join. 12 USC §§ 621, 222. The activities of Edge corporations are restricted to those attendant upon international banking and financial transactions, while national banks are authorized to engage in more traditional domestic banking. 12 USC §§ 611, 24. Edge corporations were excluded from the definition of "bank" in the Bank Holding Act of 1956, while national banks were not. 12 USC § 1841(c).

Moreover, Edge corporations do not and were not created to perform the kinds of governmental functions

[4]And, to the extent that national banks and Edge corporations are similar, "[t]he substantial erosion of state tax immunity for national banks suggests that the similarities of a national bank to an Edge corporation should not be relied upon to grant the Edge corporation state tax immunity". Note, *A Constitutional And Statutory Analysis of State Taxation Of Edge Act Corporate Branches*, 51 Fordham Law Rev 991, 1015-1016 (1983).

which originally led to the designation of national banks as federal instrumentalities. National banks were originally empowered to issue currency and functioned as the monetary and fiscal agents of the United States. *First Agricultural National Bank,* 392 US at 355-56 (Marshall, J., dissenting). Edge corporations, however, were never more than federally chartered private international financial institutions whose self-interest was deemed to be coincident with the national interest.

In sum, Edge corporations are not so intimately connected with the government that they should be immune from state taxation as federal instrumentalities. States may, therefore, tax such corporations without the need for affirmative congressional consent.

**B. Congress has created no tax immunity for out of state Edge corporation branches.**

As demonstrated above, Edge corporations have no self-executing constitutional immunity from state taxation. Congress may nevertheless confer such immunity or tax exempt status by affirmative legislative action if it so chooses. *Oklahoma Tax Comm. v Texas Co.,* 336 US 342, 365 (1949). Such intent to immunize must, however, be clear and may not be assumed or implied. *Id.* at 366, quoting *Oklahoma Tax Comm. v United States,* 319 US 598, 604 (1943) and *Graves v New York ex rel. O'Keefe,* 306 US 466, 480 (1939). Appellant contends that Congress has immunized out of state Edge corporation branches by the enactment of 12 USC § 627. This view cannot be squared with either the statute's language or its legislative intent and history.

The statutory language itself is, of course, the primary source of legislative intent. *Howe v Smith,* 452 US 473, 480 (1981). If that language is unclear, then resort may be

had to legislative history. *Blum v Stenson,* 465 US 886, 896 (1984). In the instant case, there is no indication that Congress intended to create the tax loophole appellant would have this Court fashion.

Section 627, which has not been amended since its enactment in 1919, provides that:

> "Any corporation organized under the provisions of sections 611-631 of this title shall be subject to tax by the State within which its home office is located in the same manner and to the same extent as other corporations organized under the laws of that State which are transacting a similar character of business. The shares of stock in such corporation shall also be subject to tax as the personal property of the owners or holders thereof in the same manner and to the same extent as the shares of stock in similar State corporations."

By its very terms, which are permissive rather than prohibitive, the statute provides for nondiscriminatory taxation by an Edge corporation's home office state. The language simply does not address at all, and therefore does not preclude, taxation by other states having the requisite nexus to impose a tax. As one court has observed,

> "[Section 627] speaks of no tax immunity or special tax exemption for either the corporation or its shareholders as a consequence of incorporation under the Act. While the language selected expressly permits the domiciliary state to tax the corporation and to include shares of the corporation in the valuation of the personal property of the owner for taxing purposes, nothing in either sentence of § 627 restricts or forbids taxation by any other

> state. The provision does make clear that taxing state must treat Edge Act banks the same as it treats its own state banks."

*City of Houston v Morgan Guaranty International Bank,* 666 SW2d 524, 529-30 (Tex App 1983), *cert den,* 469 US 1213 (1985). This Court itself has recognized in passing that the essential purpose of the statute is to prohibit discrimination in favor of state-chartered banks. *See, First Federal Savings & Loan Assn. of Boston v. Tax Comm.,* 437 US 255, 258 & n 2 (1978).

As explained below, when examined in context, it is clear that the statute's reference to the "State within which [the Edge corporation's] home office is located" was merely descriptive of the only state which Congress believed would have a taxable nexus with an Edge corporation; the language was not all intended to confer by implication any tax immunity with respect to other states.

As part of the Edge Act, Congress enacted 12 USC § 615(b), which provides that an Edge corporation is empowered "[t]o establish and maintain for the transaction of its business branches or agencies in foreign countries, their dependencies or colonies, and in the dependencies or insular possessions of the United States, at such places as may be approved by the Board of Governors of the Federal Reserve System and under such rules and regulations as it may prescribe * * *". Pursuant to this statutory mandate, in 1920 the Federal Reserve Board issued Regulation K, which, *inter alia,* prohibited Edge corporations from establishing domestic branches, *See,* 12 CFR § 211.6(a) (1979).[5] In other words, prior to the 1979 regulatory

[5]The regulation read:

> "A Corporation may not establish any branch in the United States, but with prior Board approval may establish agencies in the United States for specific purposes, but not generally to carry on its business."

change discussed below, the Federal Reserve Board had interpreted 12 USC § 615(b) as precluding domestic branches by virtue of its specific authorization of only foreign branches. This limitation is consistent with the legislative history, which shows that Congress was concerned with the potential abuses associated with domestic branches and intended to prohibit them. *See,* 58 Cong Rec 7856-7857, 8100, 8102.

Thus, when 12 USC § 627 was enacted, and for many years thereafter, an Edge corporation had to be individually organized in any state in which it desired to do business. It is therefore illogical to construe section 627 as prohibiting by implication the taxation of branches whose establishment was never envisioned. On the contrary, by expressly authorizing taxation in the home office state, the statute allowed the only state with a legitimate claim to do so to subject Edge corporations to unrestricted, nondiscriminatory taxation. Again, the legislative history confirms that Congress intended Edge corporations to be fully taxable entities. *See,* 58 Cong Rec 4955, 4969.

Because of section 627 and because of the prohibition against domestic branches, until 1979 there was no question that all Edge corporations were fully taxable in the state in which they operated. In that year, the Federal Reserve Board, as part of its response to the general directive in section 3 of the International Banking Act (IBA) of 1978 (PL No. 95-369, 92 Stat 607) to minimize regulatory restrictions on the operation of Edge corporations, amended Regulation K to permit for the first time the establishment of domestic branches. *See,* 12 CFR § 211.4(c)(1)(1980).[6] This departure from its prior policy

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[6]In pertinent part, it read, "With prior Board approval, an Edge Corporation may establish branches in the United States * * *".

and interpretation of the original Edge Act[7] set in motion the events leading to the instant litigation. With the advent of domestic branching, Edge corporations, such as appellant, established such branches and began to contend that out of state branches could not be taxed because of the "home office" language in section 627.[8] It is respectfully submitted that the change in regulatory policy following the enactment of the IBA does not operate so as to create, as an unintended consequence, a heretofore nonexistent tax exemption.

Regardless of the validity of the Board's regulatory change, it remains that (1) Edge corporations are not federal instrumentalities taxable only with the affirmative consent of Congress, (2) 12 USC § 627 contains no express prohibition of the taxation of Edge corporations branches, and (3) Congress intended to make Edge corporations fully taxable. Thus, appellant's branch offices in New York, where they receive all the benefits and protections afforded by the state, may properly be assessed their fair share of taxes.

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[7]The IBA did not amend 12 USC § 615(b), the source of the domestic branch prohibition. The Federal Reserve Board's radical change in policy absent a specific legislative change does indeed, as appellant suggests, place in doubt the validity of the new regulation. This question need not, however, be resolved here.

[8]The IBA also did not amend 12 USC § 627.

## CONCLUSION

**Appellee's motion to dismiss or affirm should be granted on the ground that no substantial Federal question has been presented.**

Dated: Albany, New York
July 15, 1987

Respectfully submitted,

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